



# The Israeli Banking System: Recent developments and challenges

S&P meeting with the Bank of Israel  
Banking Supervision Department

April, 2023 (Q4/2022)



Israeli banks showed resilience to the Covid-19 crisis. Their current financial position is solid. It enables them to soundly face post pandemic developments: global events, macro economic uncertainty, rising interest rates, increased inflation and competition.



# The Banking Supervision Department's Objectives



## Stability

Maintaining the resilience of the banking system to safeguard the public's deposits and to ensure the banking system's support for economic activity



## Fairness

Providing consumer protection, and promoting an inclusive and effective banking system



## Competition

Promoting a competitive and advanced banking system



## Operating Model

Adjusting BSD's operational model to the evolving financial eco-system



## BSD'S areas of focus (2022-2023)



**Post-pandemic macro-economic uncertainty and developments** (rising inflation, interest-rate environment, real-estate sector, global events and judicial reform)



**Promote operational resilience** in light of increased complexity of operating environment and increased reliance on third-party service providers



**Enhance competition, digitalization & innovation** in the banking system, e.g., expansion of open banking; online switch system between banks; granting bank license to two new banks.



**Improve alignment of supervisory and regulatory activity with the changing operating environment**, including the use of Sup-tech tools. Supported by the IMF specialists



**Improve consumer protection regulation and supervisory assessment and examination (enforcement actions)**, including the use of fines and transparency tools



**Assess banks' vulnerability to the real-estate sector** as housing loans and real-estate credit increase



**Regulatory impact assessment (RIA) and improved supervisory and banks' transparency**, e.g., BSD's regulatory and policy measures; proper disclosure and customers' ability to compare prices in the mortgage market



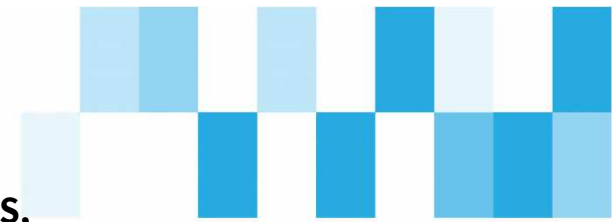
**Develop ESG supervisory examination framework and climate-related risk management guidelines**, including proper disclosure requirements, new regulation and performing climate stress test.



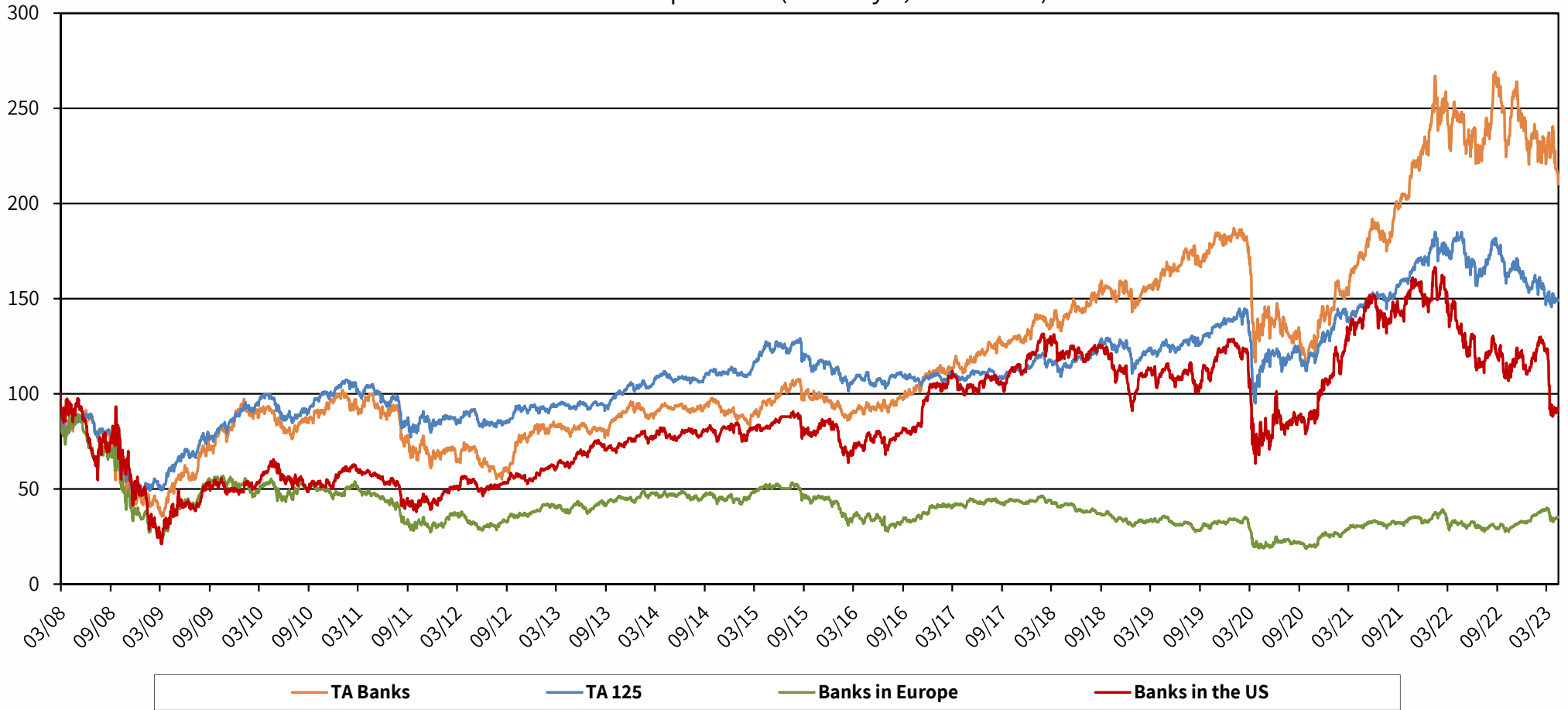
# Trends and recent developments



# High market valuation



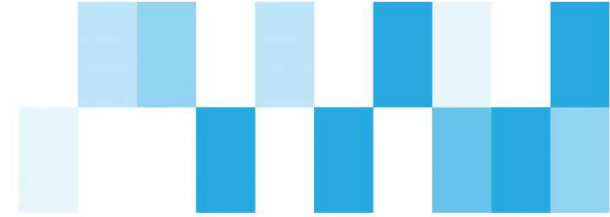
**Tel Aviv 125 Index and Bank Shares Index in Israel,  
Bank Shares Index in Europe, and Bank Shares Index in the US,**  
March 2008 - April 2023 (January 1, 2008 = 100)



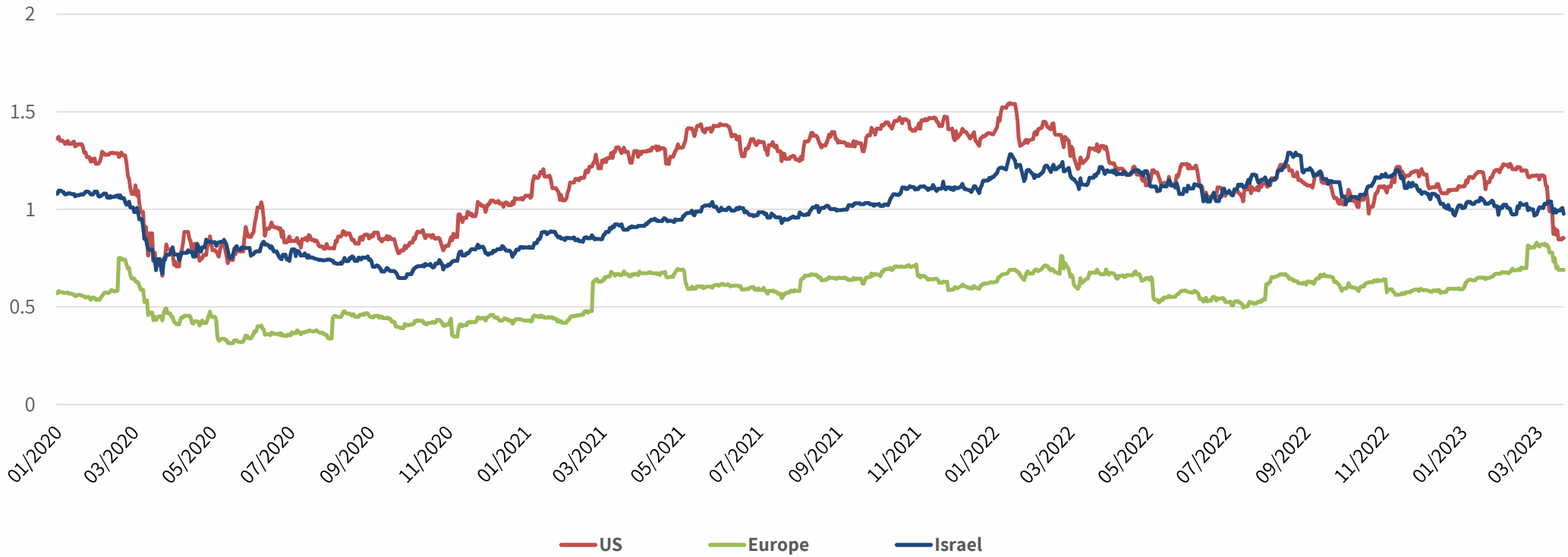
.SOURCE: The Tel Aviv Stock Exchange



# High market valuation of Israeli banks



The MV/BV Ratios in the Banking Industry,  
Israel and Selected Countries <sup>a</sup>, 2020 - March 2023



<sup>a</sup>Israel - Bank of Israel Banks Index; UK - FTSE 350 Banks Index; Europe - MSCI Europe Banks Index; US - KBW Bank Index.

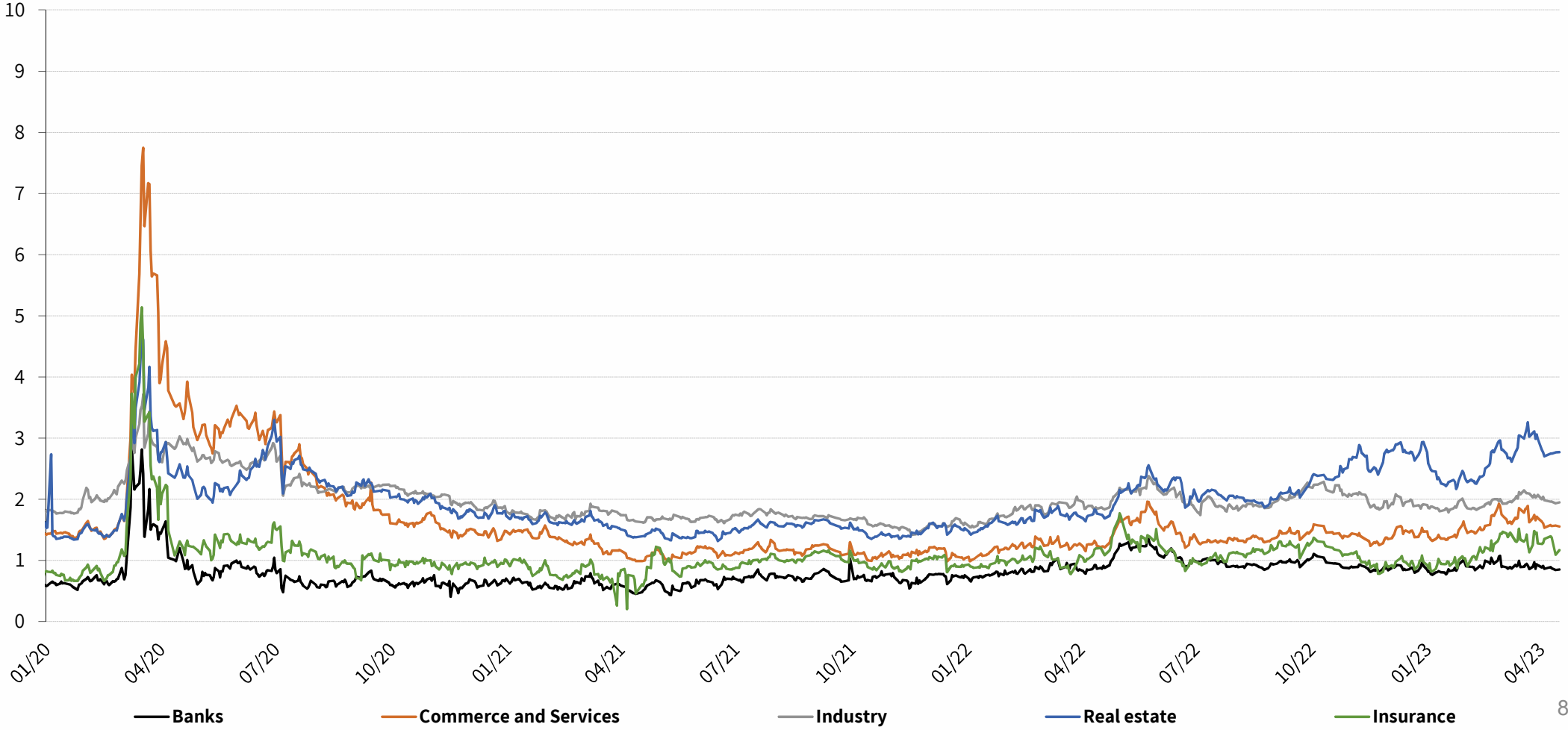
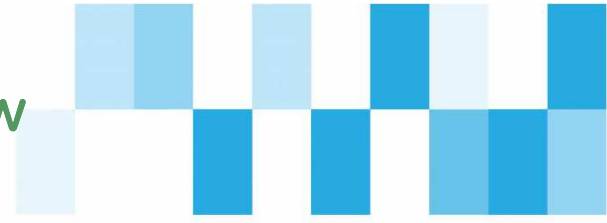
SOURCE: Based on Bloomberg and Tel Aviv Stock Exchange.



# The spread of banks' corporate bonds remains low

## CPI-Indexed Corporate Bonds' Spreads by Industry

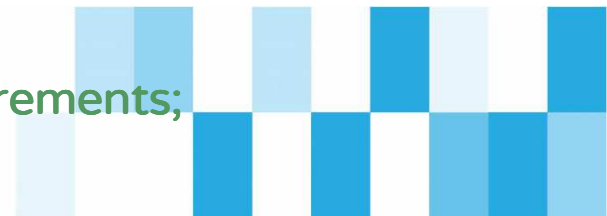
January 2020 - April 2023



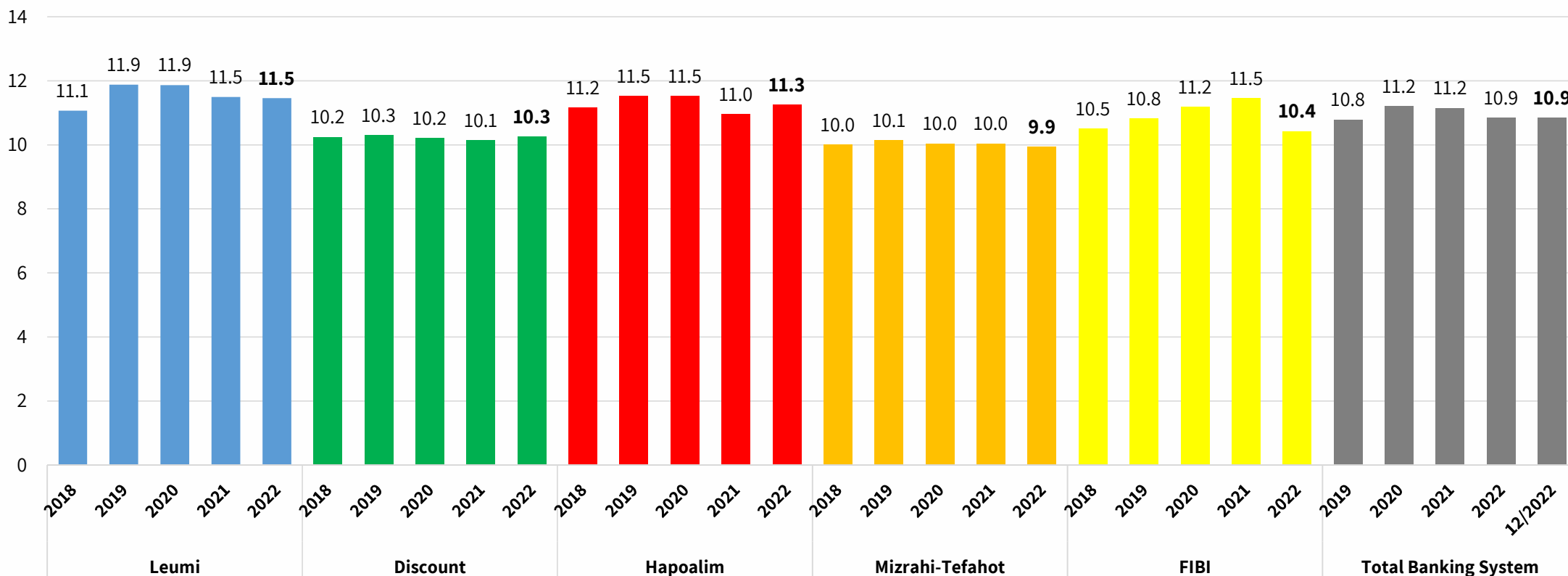




# Capitalization: Banks' capital is well above regulatory requirements; CET1 remained stable as of December 2022



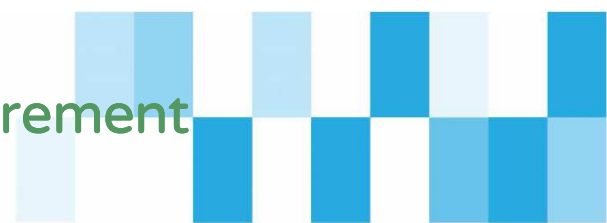
**Common Equity Tier 1 Capital Ratio <sup>a</sup>**  
Total Banking System, December 2018 – December 2022



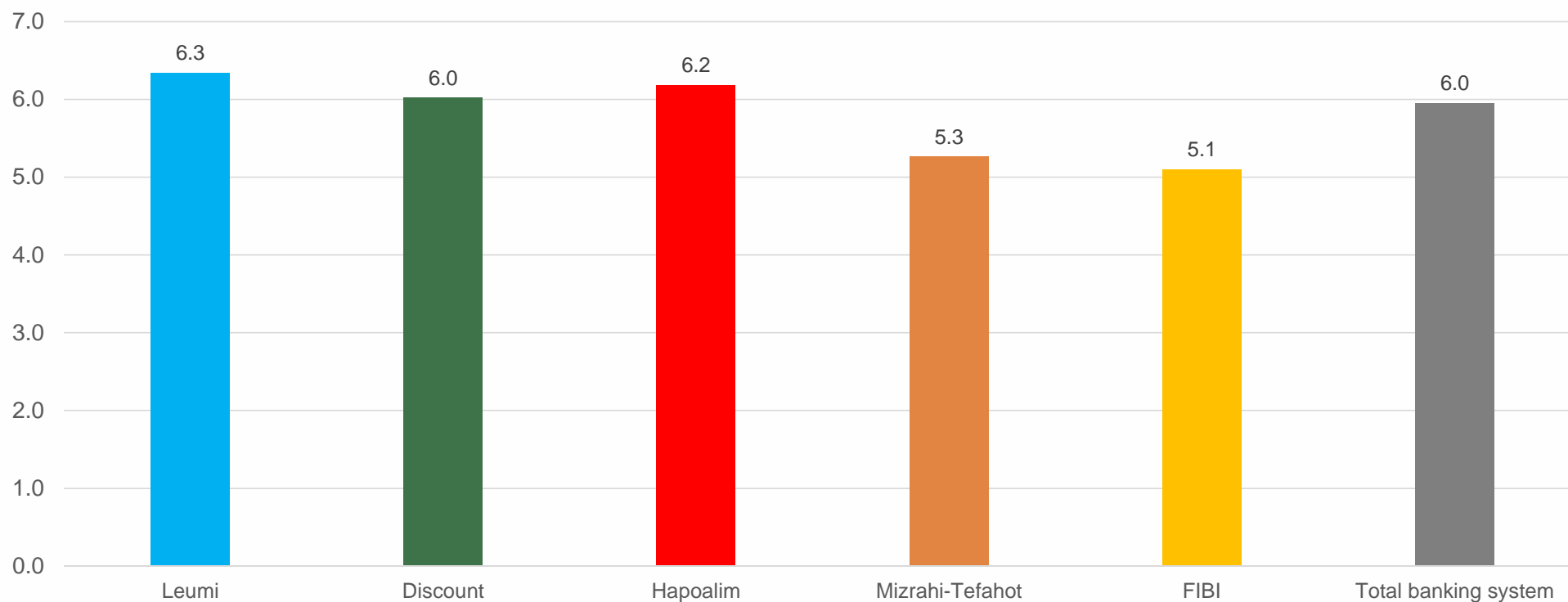
<sup>a</sup> In Basel III terms (Common Equity Tier 1 capital ratio) in accordance with the transition directives.  
**SOURCE:** Based on published financial statements and reports to the Banking Supervision Department.



# Leverage ratio is well above Basel III minimum requirement



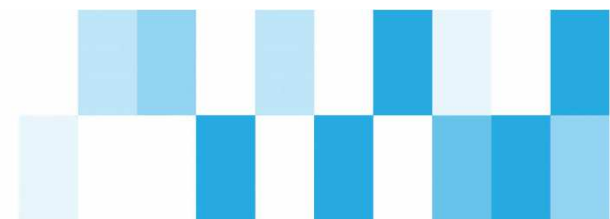
Basel III Leverage Ratio  
Total Banking System, December 2022



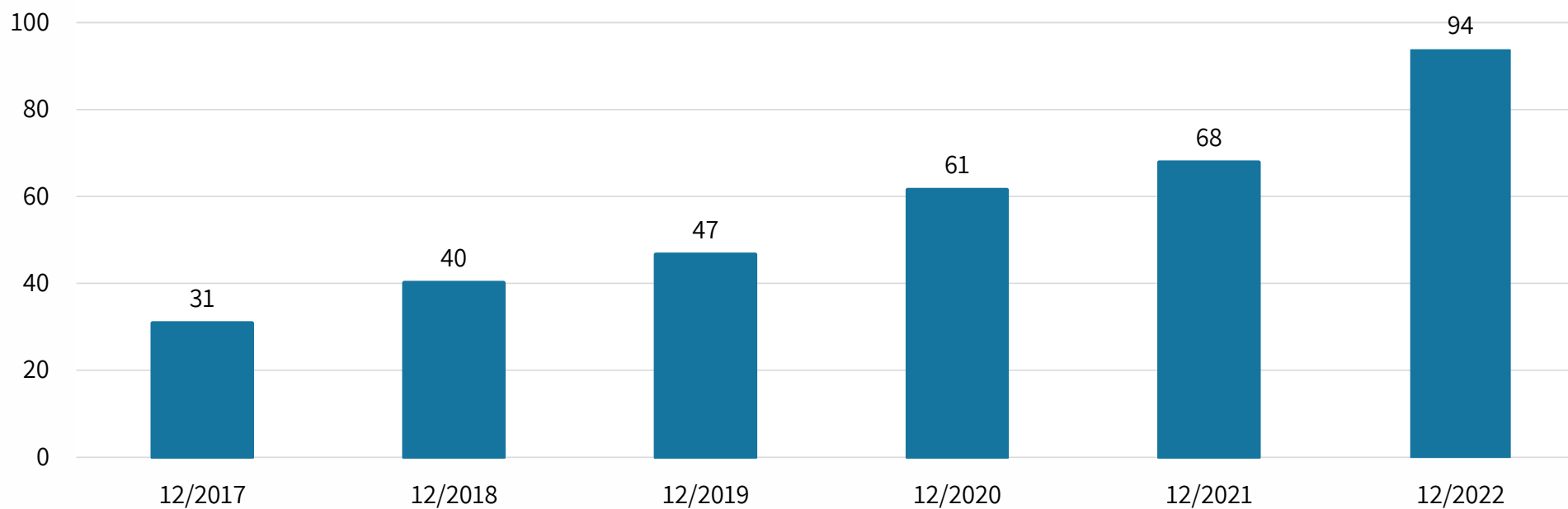
**SOURCE:** Based on published financial statements and reports to the Banking Supervision Department.



## Positive net CPI-indexed asset position

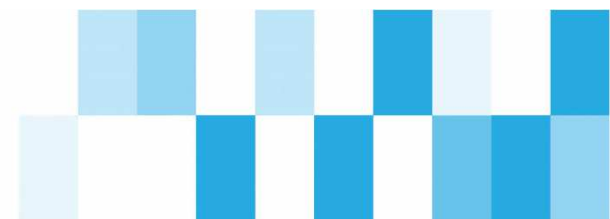


Net CPI-indexed asset position  
2016-2022, NIS Billions

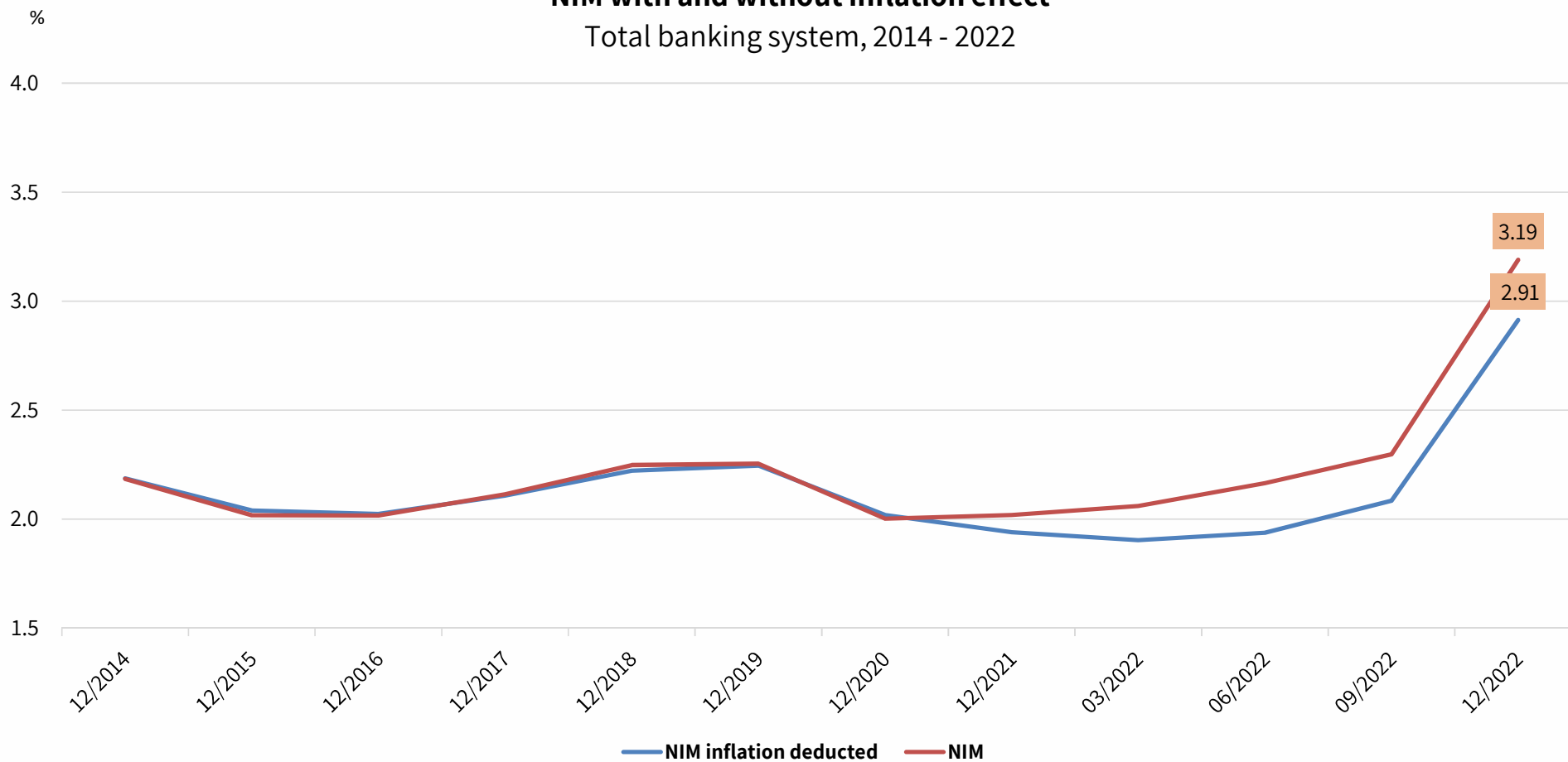




# Positive effect of inflation on banks' profit reflected in Net Interest Margin (NIM)

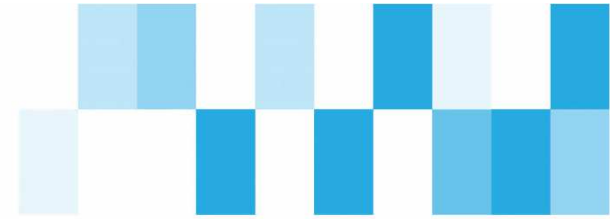


**NIM with and without inflation effect**  
Total banking system, 2014 - 2022

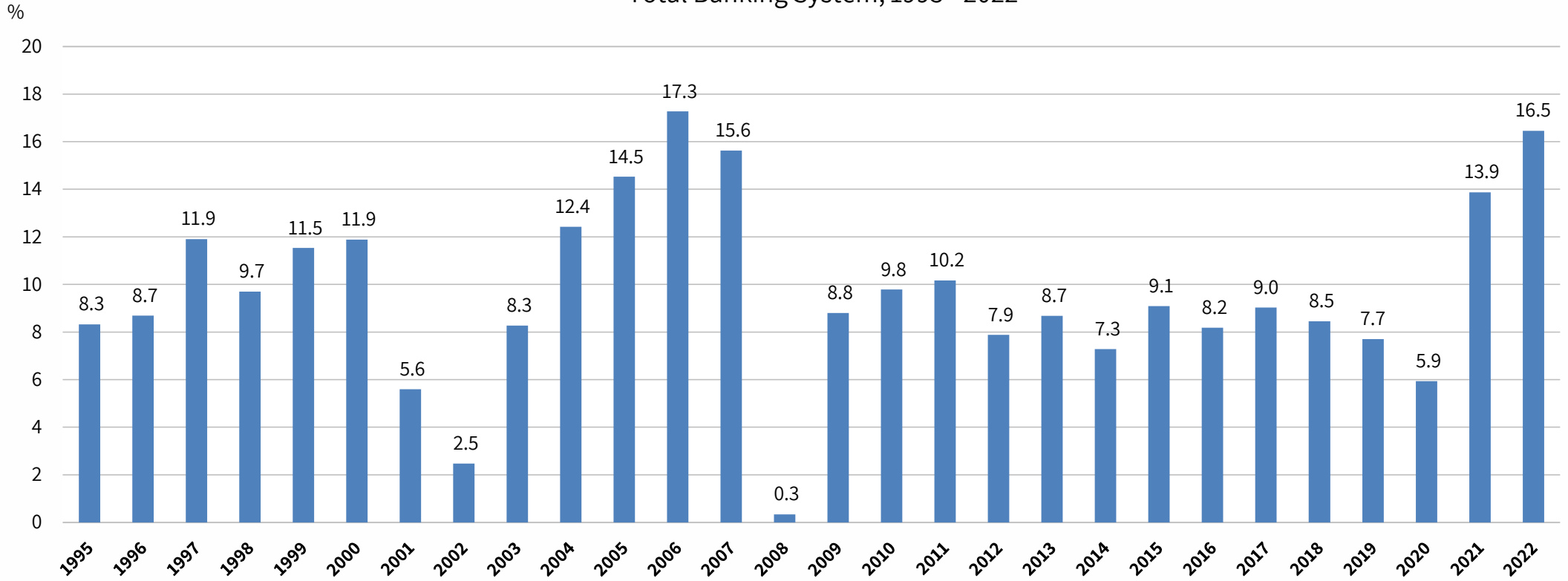




## Adequate profitability over time



**Return on Equity (ROE),**  
Total Banking System, 1995 - 2022



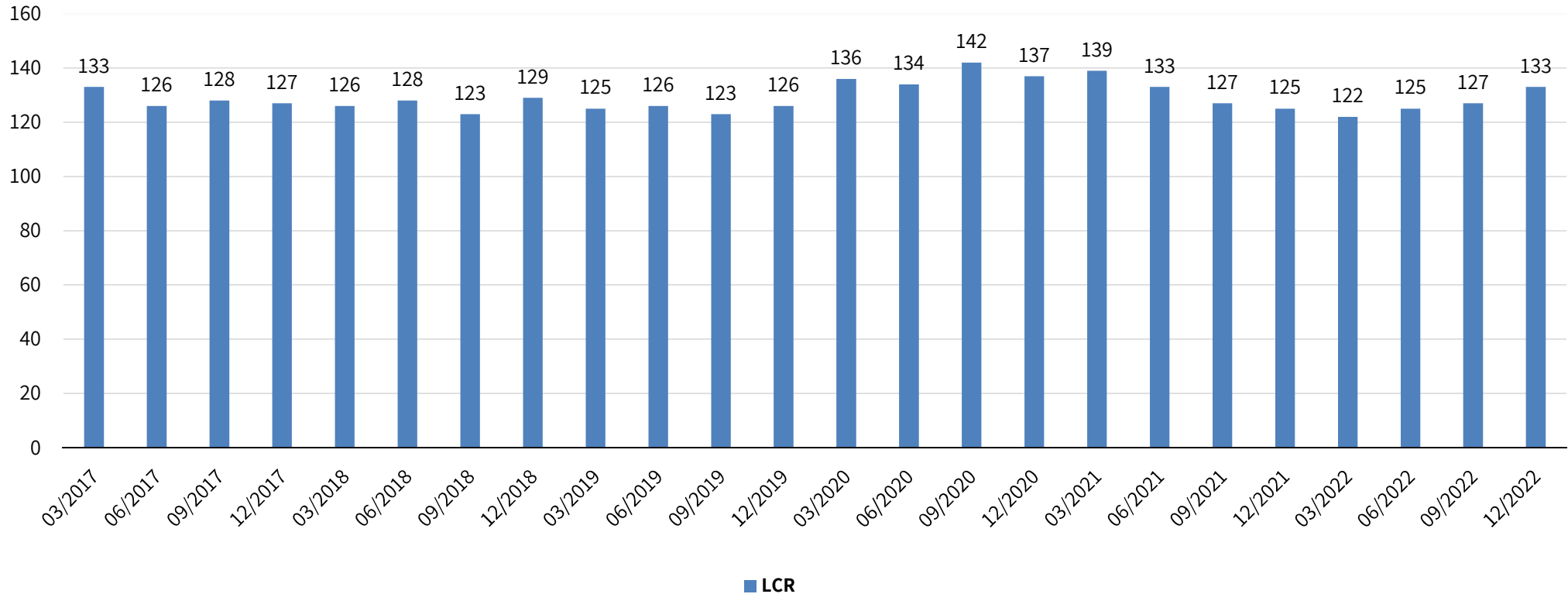
**SOURCE:** Based on published financial statements and reports to the Banking Supervision Department.



# Liquidity Coverage Ratio is adequate and increased during the crisis

## Liquidity Coverage Ratio (Total Activity)

Total Banking System<sup>1</sup>, 2017 to 2022

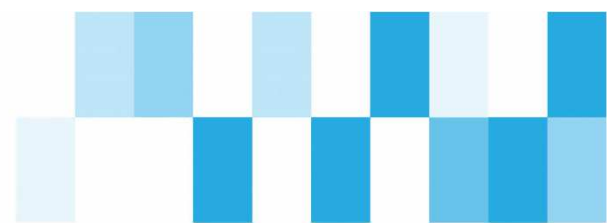


<sup>1</sup> Calculated on a consolidated basis.

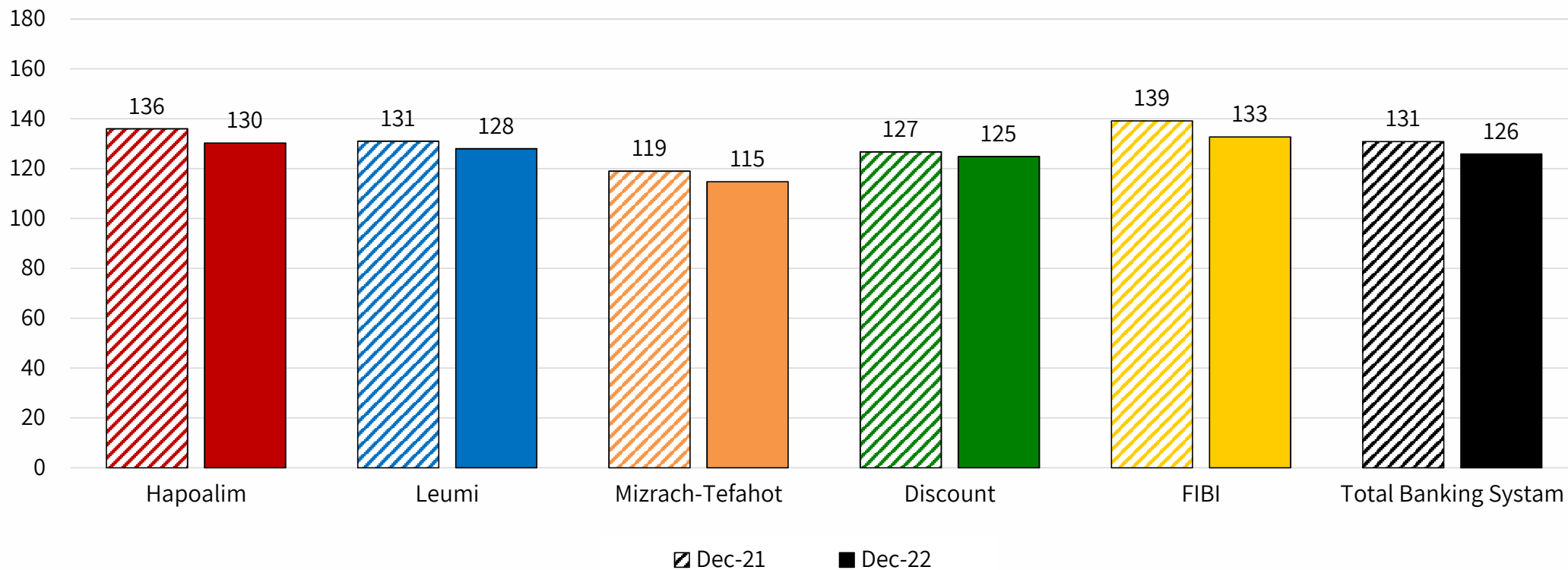
**SOURCE:** Based on published financial statements and reports to the Banking Supervision Department



# Adequate stable funding ratio



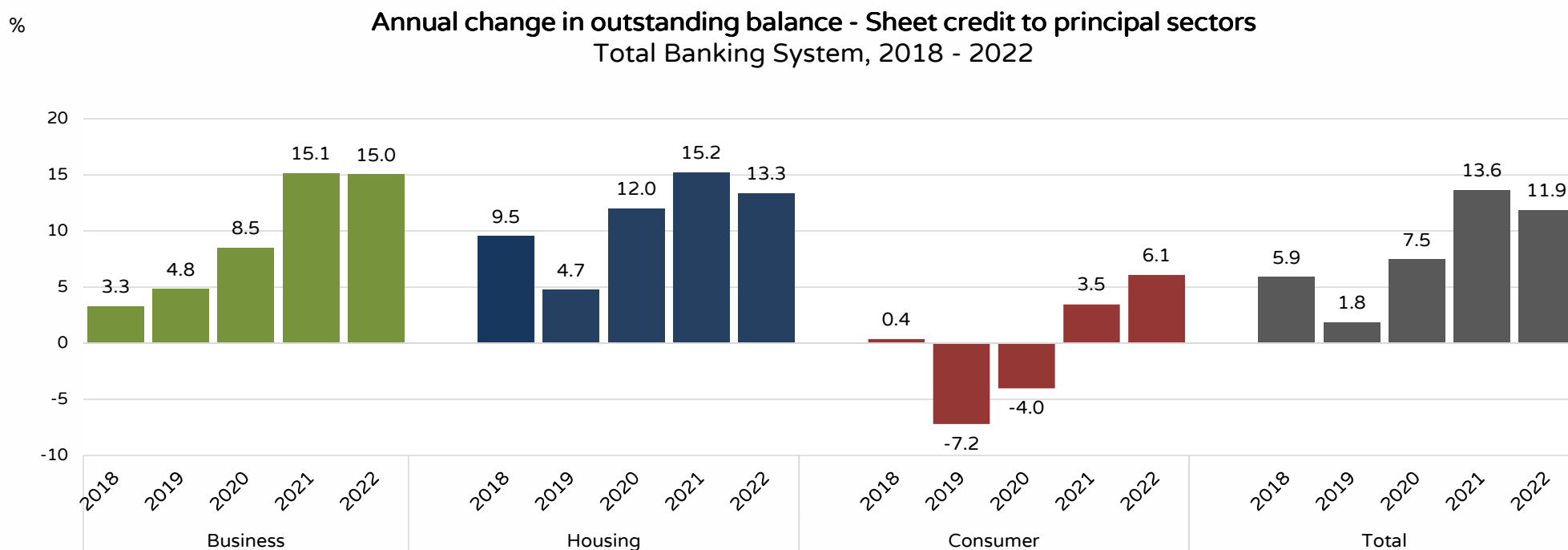
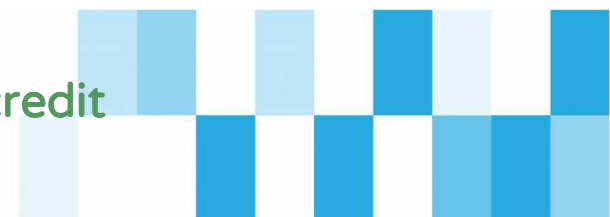
### Net stable funding ratio (NSFR) December 2021 and December 2022



SOURCE: Based on published financial statements and reports to the Banking Supervision Department.



## Relatively high levels of growth rate in business and housing credit as of December 2022



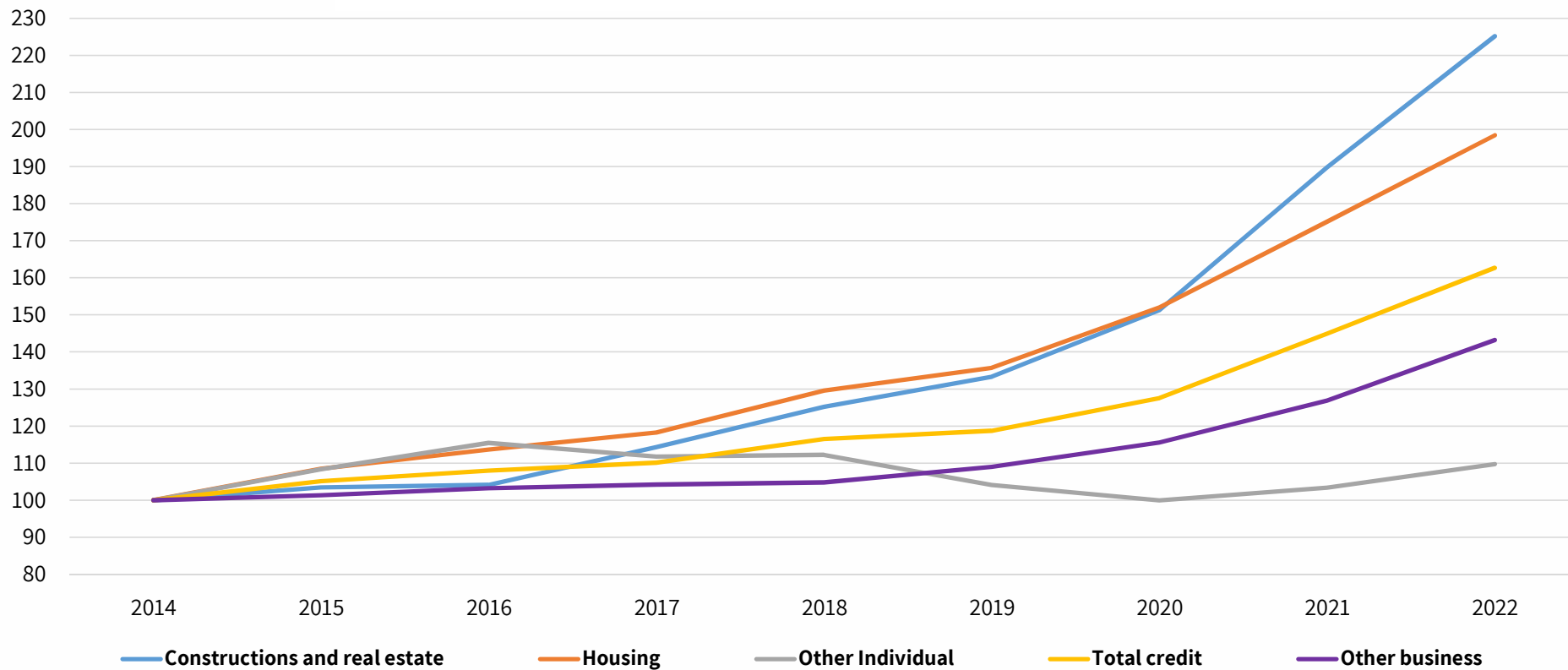
SOURCE: Based on published financial statements and report to the Banking Supervision Department





# Main credit growth factors are housing, construction and real estate

Development of credit in the various activity segments,  
Total Banking System, 2014 –2022 (2014 = 100)

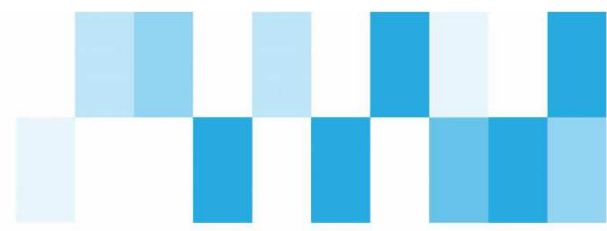


The decrease in the consumer credit in 2018-2019 caused by the selling of the credit card companies.

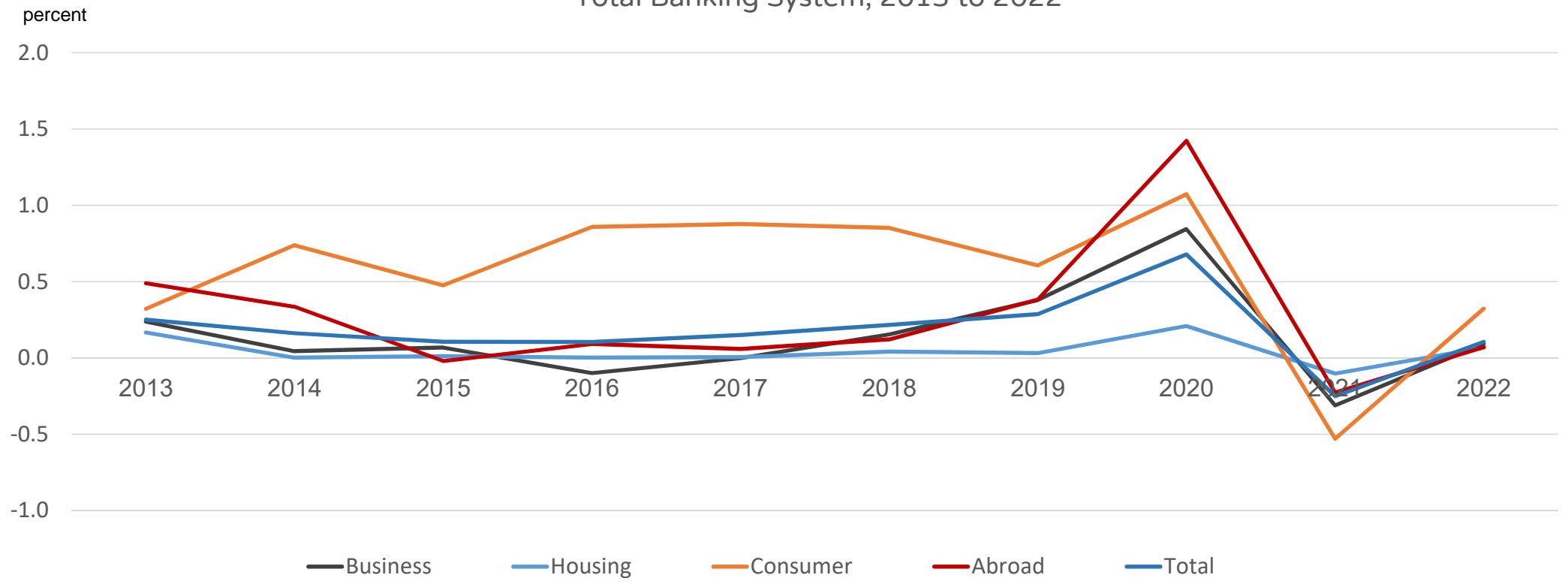
**SOURCE:** Based on published financial statements and report to the Banking Supervision Department.



# Historically low levels of loan-loss provisions



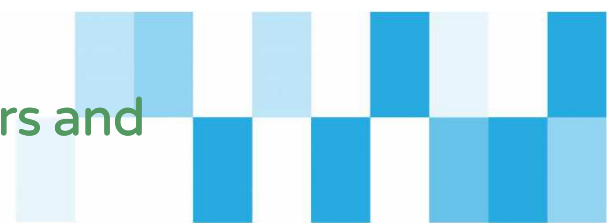
### Loan-Loss Provisions to Total Balance-Sheet Credit to the industry Total Banking System, 2013 to 2022



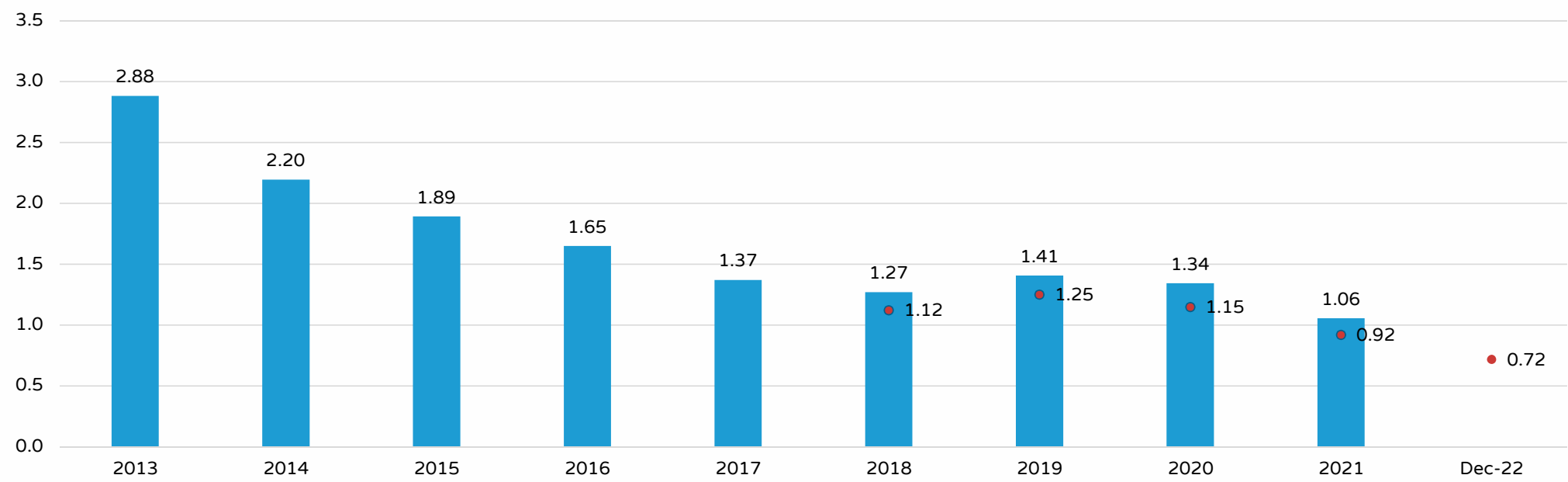
SOURCE: Based on published financial statements



# Share of NPL remained low and stable in the past four years and during the Covid-19



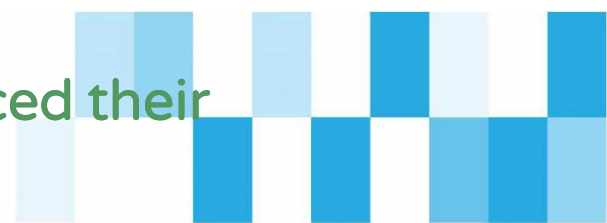
### Non-Performing Loans\* Total Banking System, 2012 - 2022



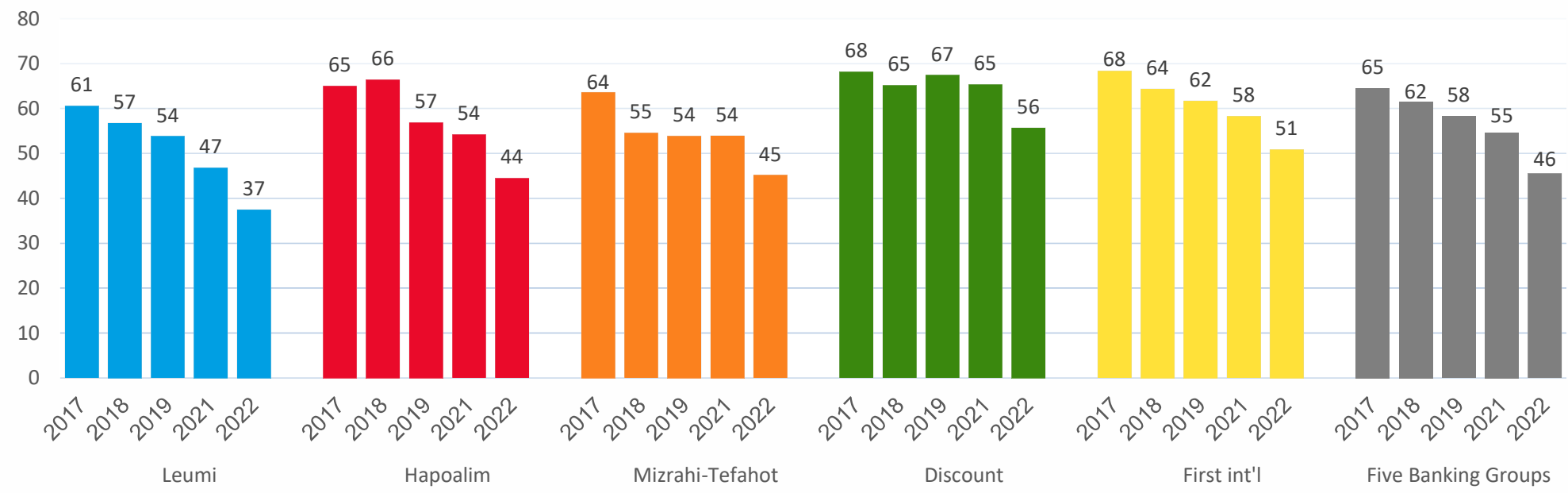
\* Impaired loans and non-impaired loans 90 days or more past due as a share of total balance-sheet credit to the public.  
• **Data until 2018** represents impaired loans and 90 days or more past due; non-impaired loans as a share of total balance-sheet credit to the public.  
• **Data from 2018** and on also represents non-accrual loans and 90 days or more past due accrual loans (in red) - CECL.



# Stringent measures taken by Israeli banks have reduced their historically high operating costs



**Efficiency Ratio<sup>1</sup>**  
Total Banking System, 2014-2022

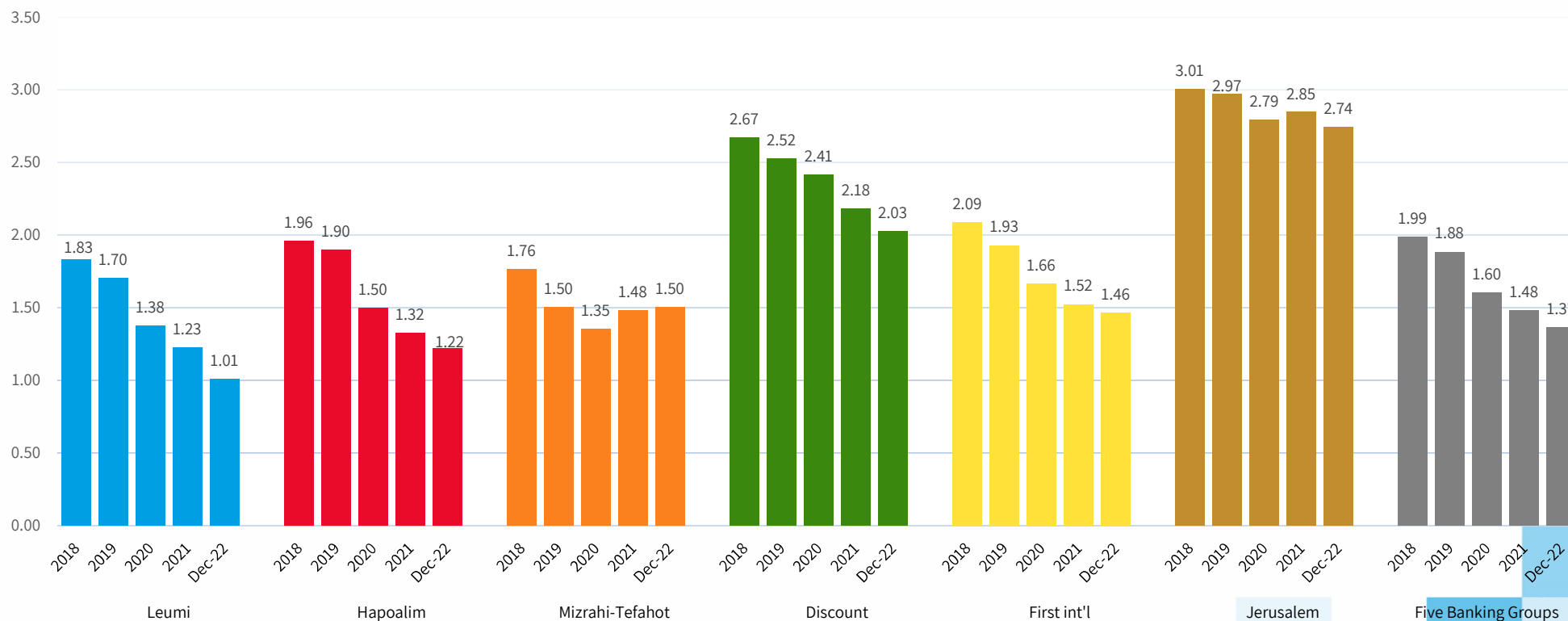


1) The ratio between total operating and other expenses and total net interest income and noninterest income (cost to income).  
**SOURCE:** Based on published financial statements and reports to the Banking Supervision Department.



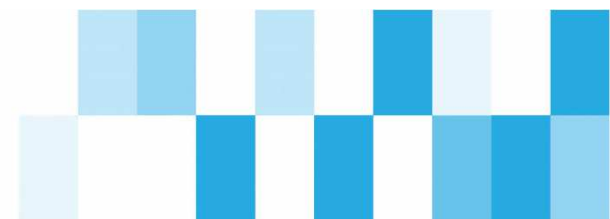
# Stringent measures by Israeli banks have reduced their historically high operating costs

The cost per unit of capacity<sup>1</sup>  
Total Banking System, 2018- 2022

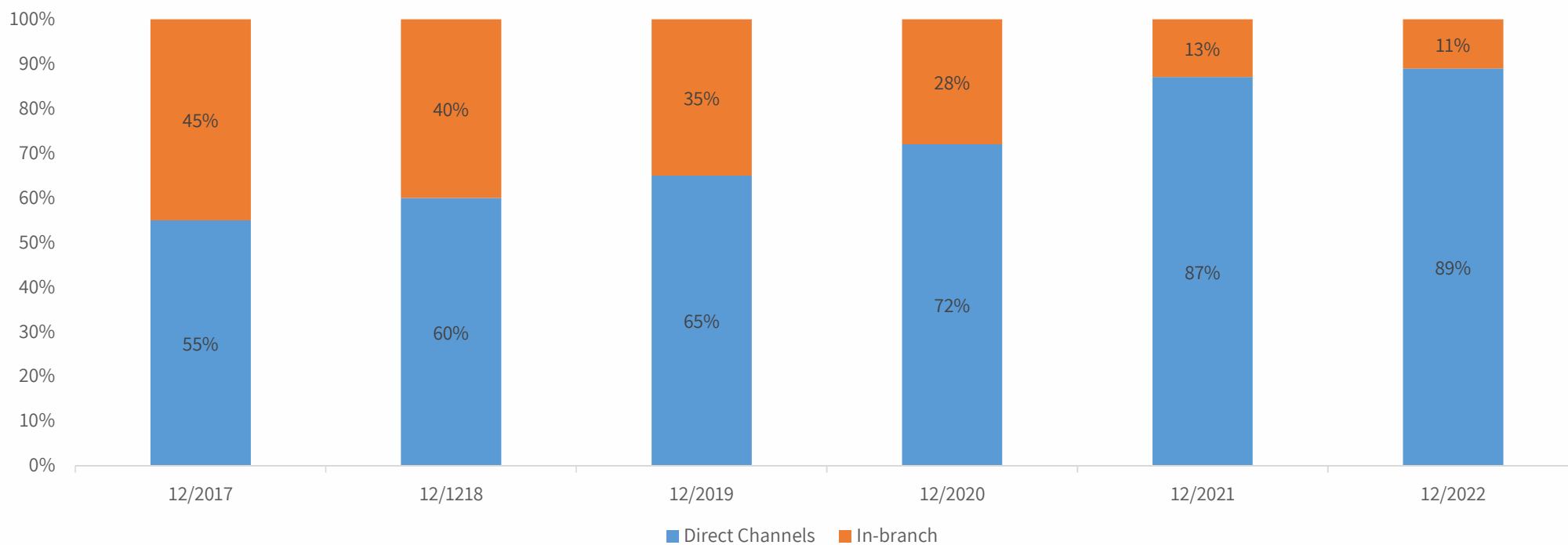




## Use of direct channels by customers is increasing



Share of transactions carried out by households via direct channels and in-branch transactions, 2017 - 2022



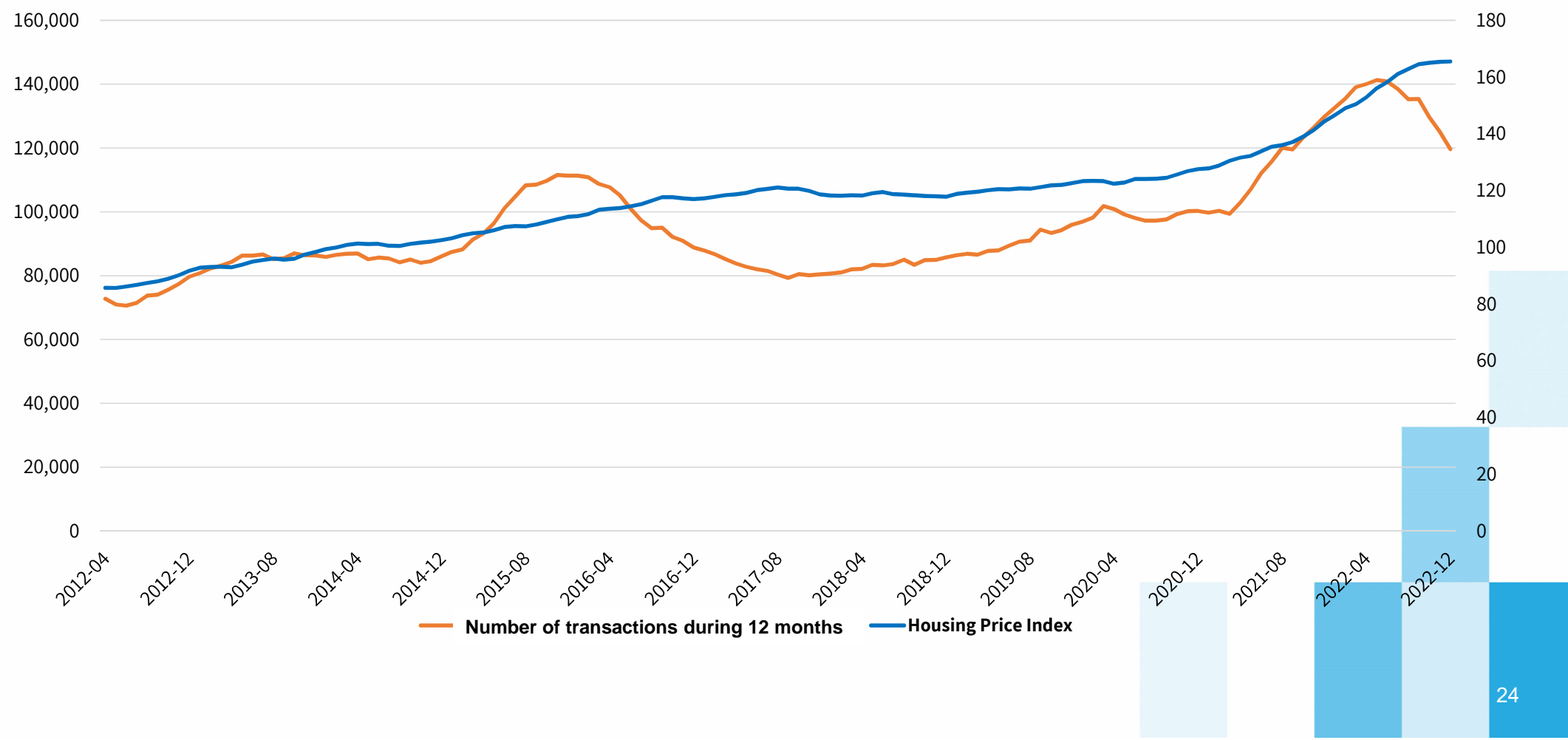


# Housing market and housing loans market



# Surge in housing market activity

## House-Price-Index and Number of Transactions in the Housing Market, April 2012 – December 2022

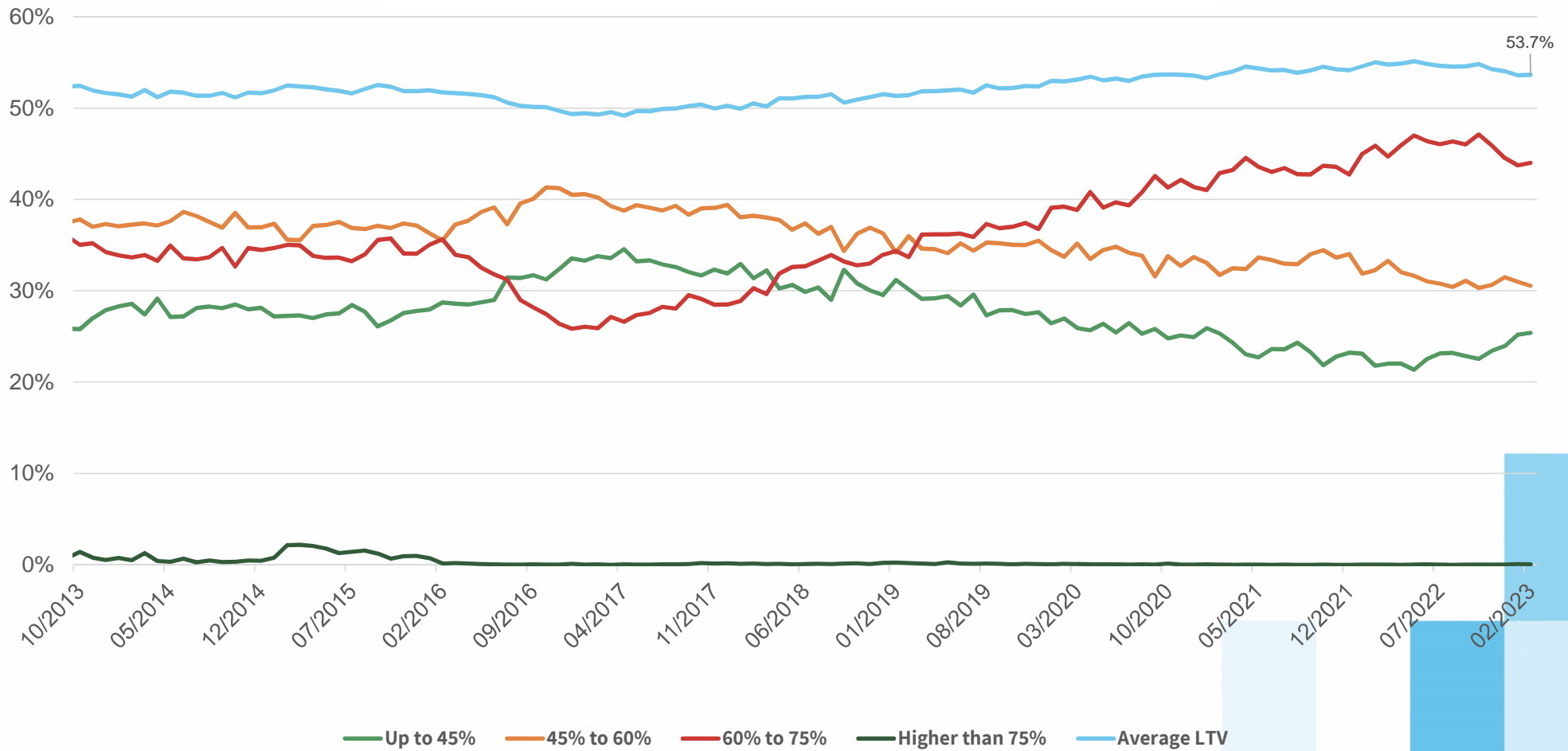






# Gradual increase in share of high LTV ratio loans

Distribution of loans for housing by LTV (Loan-to-value) ratio,  
Total Banking System October 2013 - February 2023

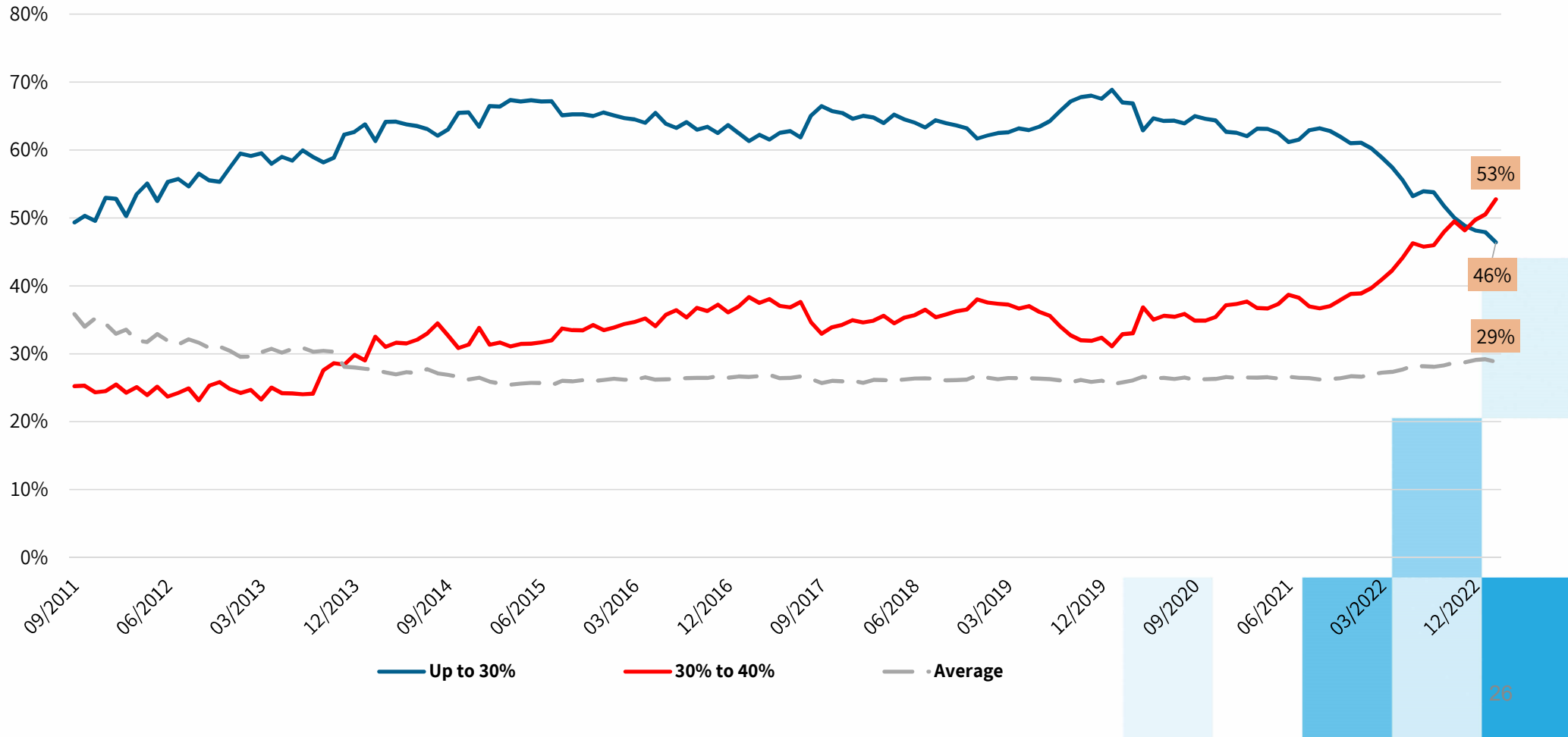




# Gradual increase in share of high PTI ratio loans

## Distribution of Loans for Housing by PTI (Payment to Income) Ratio

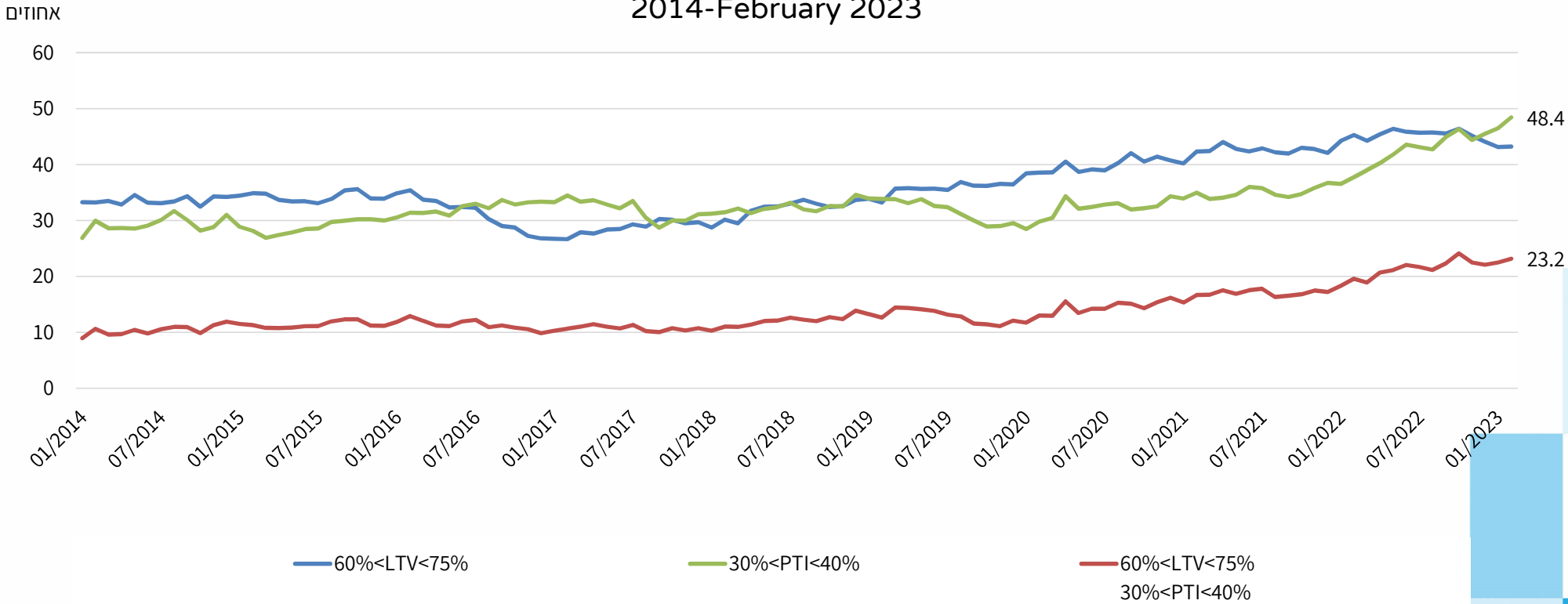
Total Banking System, September 2011 - December 2022





# Higher share of high risk profile housing loans

Share of loans with both high LTV and high PTI rates  
2014-February 2023

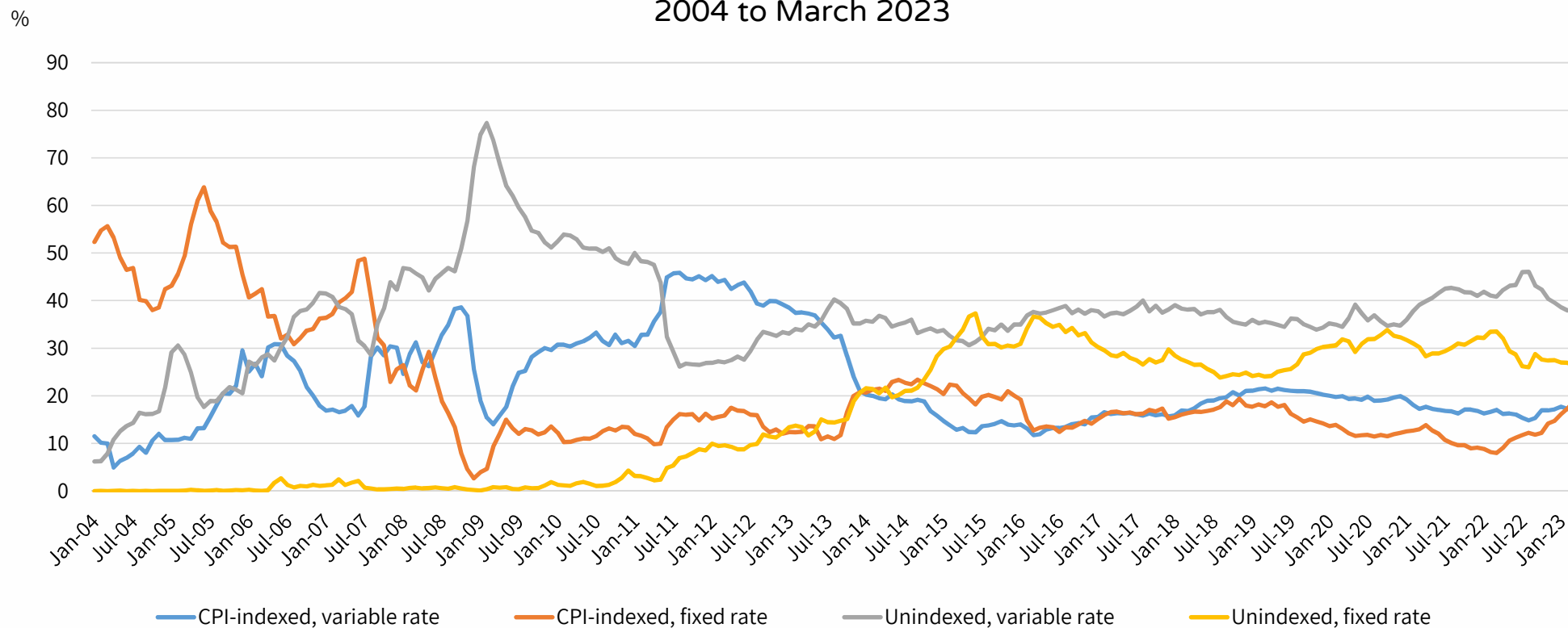


SOURCE: Based on published financial statements and report to the Banking Supervision Department.



# Moderate increase in share of variable rate housing loans

## Distribution of mortgages by Type of Indexation and Type of Interest<sup>1</sup> 2004 to March 2023



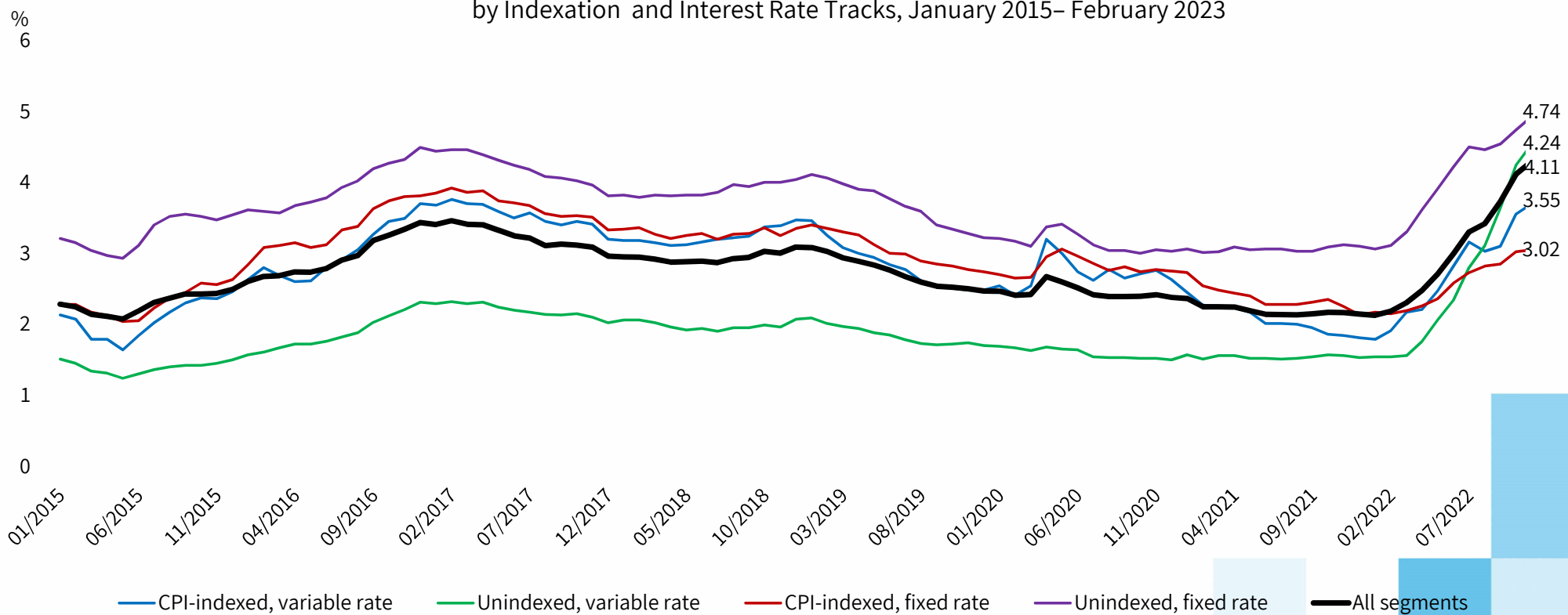
<sup>1</sup> Prime rate is the main credit in Unindexed, variable rate.

**SOURCE:** Based on published financial statements and reports to the Banking Supervision Department.



# Inflation and rising BOI's interest rate lead to an increase in new housing loans rate

### Interest rates on Housing Loans Issued by Indexation and Interest Rate Tracks, January 2015– February 2023





# Competitive landscape



# Multiple measures to enhance competition

**Setting a new supervisory objective** to promote a competitive and advanced banking system



**Implementing "Open Banking"** to enable licensed and supervised third parties to gain access to customer's information



**Simplifying new banks licensing process** publishing policy guidelines and creating a regulatory certainty in the early stages and granting a banking license to two new banks



**Launching an online bank account switching system** to enable banks' customers to switch between banks easily



**Separating two of the credit-card companies** from the largest banks. The potential separation of the third company is under review



**Removing regulatory barriers for digital banking activity** remote face-to-face identification and authentication, enabling banks to open a retail bank account online



**Simplifying mortgages and improving transparency** in credit and deposits prices



**Enhancing proportionality in bank regulation** Adapting existing regulation and supervision



**Generating a Centralized Computer Bureau** to provide technological services to new banks (jointly with the MoF).

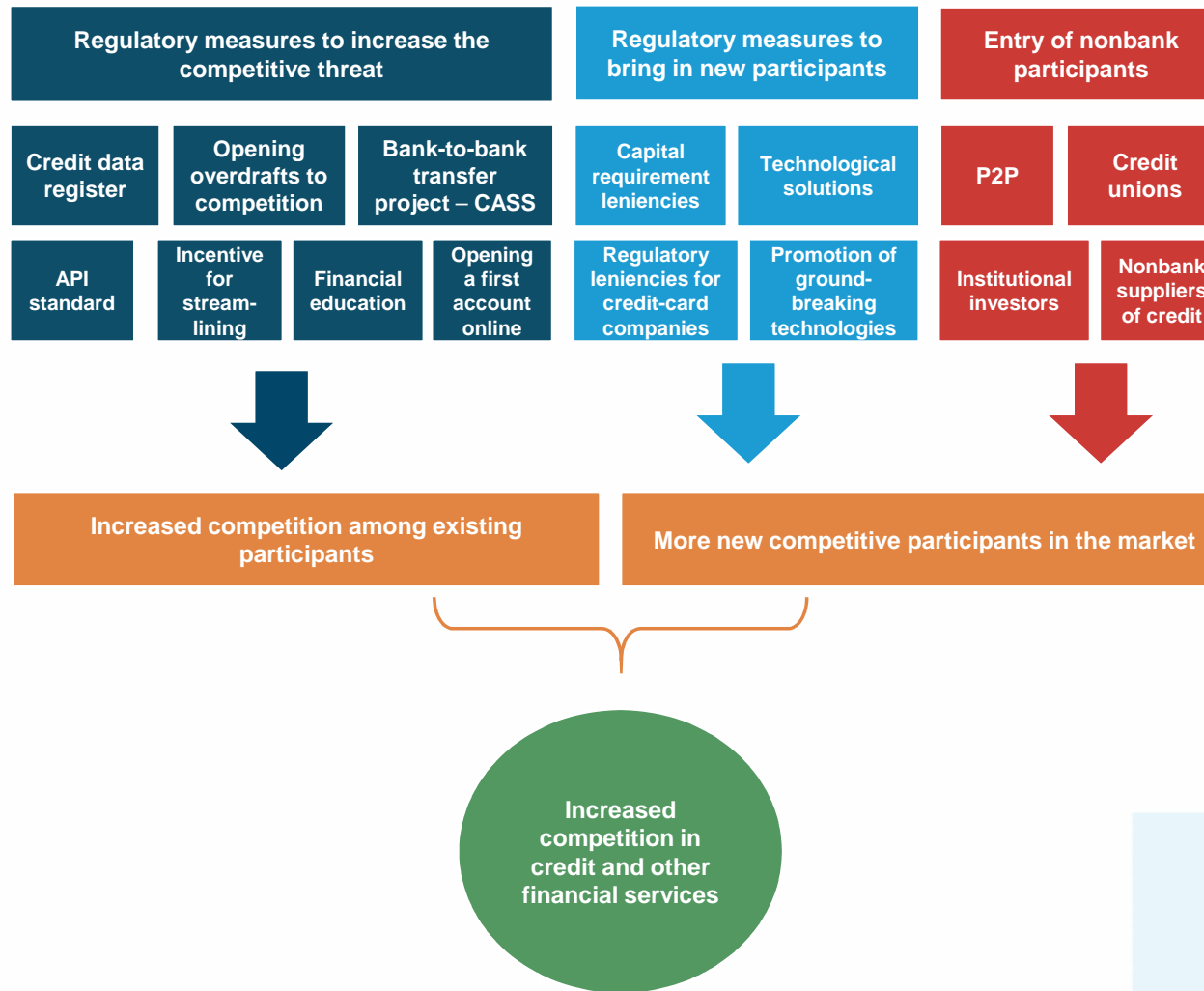


**Forming a central credit register (CCR)** for sharing credit data in Israel (jointly with the BoI)





# BSD's approach for increasing competition in banking services

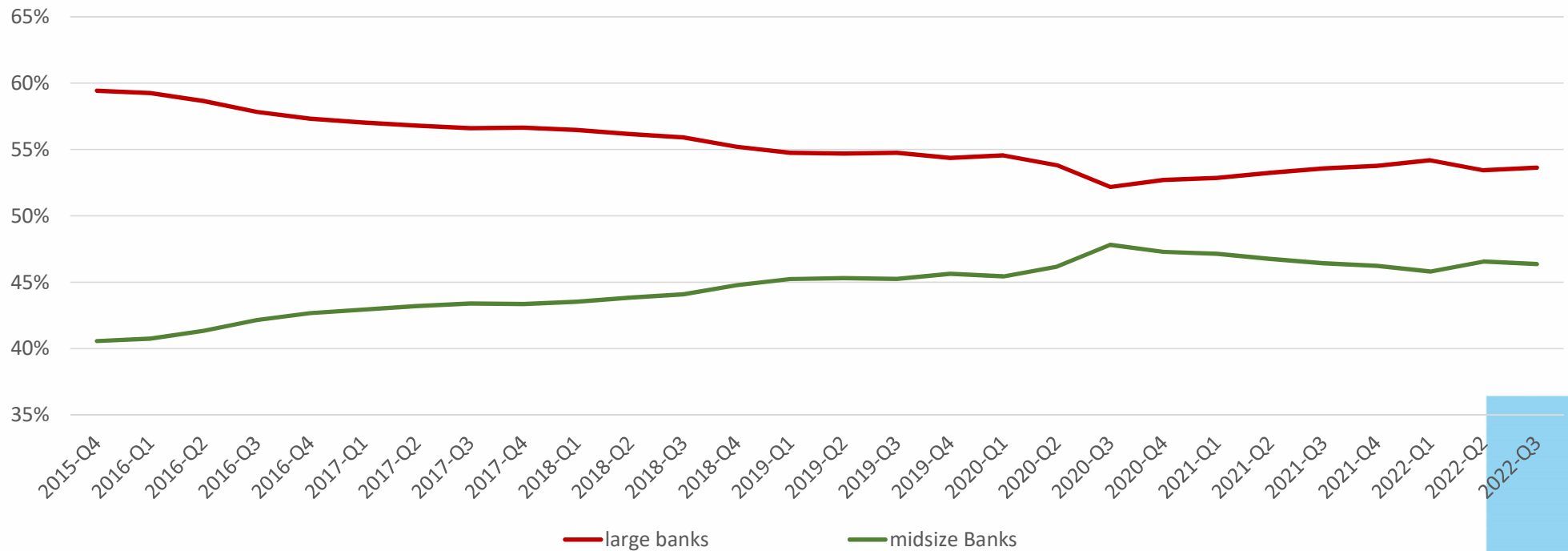






# Market share of the two largest banks is decreasing

Credit market share<sup>1</sup>  
large and midsize banks<sup>2</sup>, 2015 - 2022



\* The growth in the midsize banks' share in September 2020 was caused by the acquisition of Union Bank by Mizrahi-Tefahot.

<sup>1</sup> Balance sheet credit (activity in Israel), credit-card companies deducted.

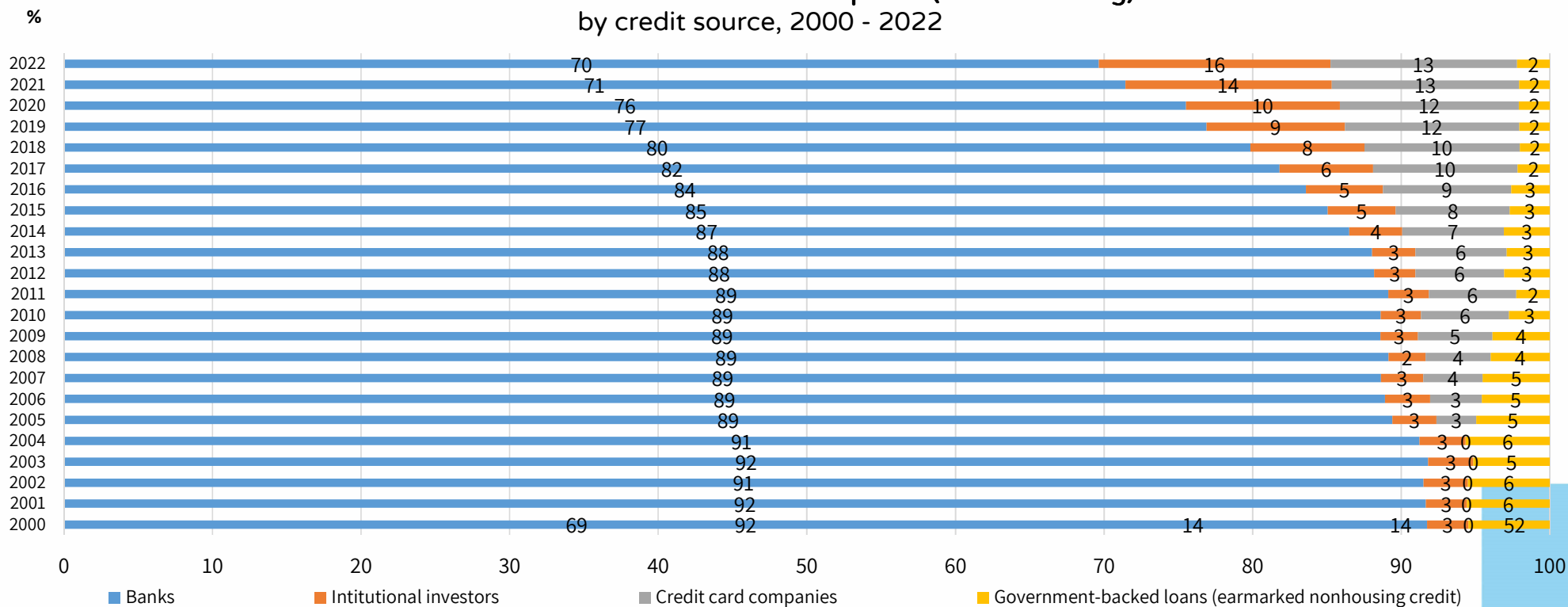
<sup>2</sup> Large banks - Leumi and Hapoalim. Midsize banks - Discount, Mizrahi-Tefahot, First Int'l.

**SOURCE:** Based on reports to the Banking Supervision Department.



# The market share of banks in total household credit is decreasing

Distribution of consumer credit to the public (not for housing) by credit source, 2000 - 2022



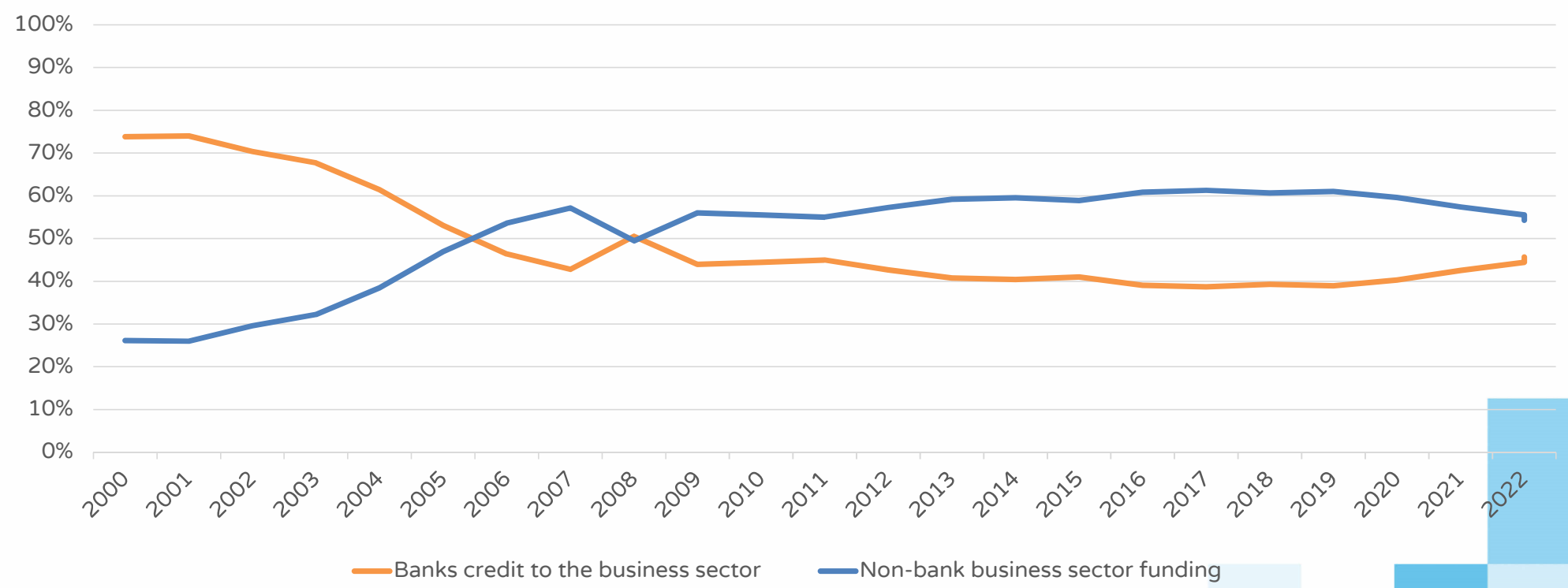
<sup>1</sup>The data includes the companies: Mimun Yashir, Derech Ashrai and Alber Credit.

**SOURCE:** Based on published financial statements and the Tel Aviv Stock Exchange Ltd.



# A growing share of non-bank business credit

## Share of bank business credit versus non-bank business credit and others 2000 - 2022



SOURCE: Based on published financial statements and the Tel Aviv Stock Exchange Ltd.



# Regulation, risks & challenges



# BSD regulatory framework (April 2023)

## Adopting BCBS standards and guidelines

- IRRBB
- Large borrowers
- Capital adequacy-RWA (operational risk, credit risk, market risk)
- Principles for sound management of operational risk and operational resilience

## ESG risk management and disclosure

- Adoption of BCBS principles for the effective management and supervision of climate-related financial risks (work in progress)
- Considering further expanding ESG and climate-risk disclosure requirements

## Proportionality

- New banks
- Credit-card companies
- Acquirers
- DSIB

## Local matters

- Housing loans
- Updating regulation in the area of capital markets activity

## Model risk management

- New regulation on pipeline
- Gaining knowledge on AI/ML models



## Challenges and risks currently facing the Israeli banking system

- **Post-pandemic macroeconomic developments** – uncertainty regarding mid-to-long term effect of global and local events on economic activity and economic growth, inter alia the effect of rising inflation and interest-rate environment, judicial reform.
- **Business models' risk** in light of the evolving financial and technological landscapes. Increased dis-intermediation due to financial innovation and increased competition, change in customers preferences and digital disruption.
- **Increased operational risk** remains one of the main concerns. Reflected in the number of cyber attacks, their increased magnitude; the complexity of operating environment, especially the increase in reliance on third-party service providers, remote working and data protection, IT operating systems and digitalization processes.
- **Credit risk** – moderate credit risk, with areas of weakness resulting from high share of CPI indexed loans and potential effect of global inflationary pressure on businesses.
- **Construction, real estate and mortgages** – there is not a concrete threat to real estate and mortgage credit quality in the short term, yet a continuation of inflation may affect HH disposable income and increase PTI.
- **Financial reforms** - Open Banking, RIA, Institutional Arrangements for Financial Supervision.



תודה THANK YOU شکرا جزيلا